

§ 1.907(a)-1

26 CFR Ch. I (4-1-03 Edition)

(3) *FOGEI taxes* mean foreign oil and gas extraction taxes as defined in section 907(c)(5).

(4) *FORI taxes* means foreign taxes on foreign oil related income. See § 1.907(c)-3.

(c) *FOGEI tax limitation*. Section 907(a) limits the foreign tax credit for taxes paid or accrued on FOGEI. See § 1.907(a)-1.

(d) *Reduction of creditable FORI taxes*. Section 907(b) recharacterizes FORI taxes as non-creditable deductible expenses to the extent that the foreign law imposing the FORI taxes is structured, or in fact operates, so that the amount of tax imposed with respect to FORI will be materially greater, over a reasonable period of time, than the amount generally imposed on income that is neither FOGEI nor FORI. See § 1.907(b)-1.

(e) *FOGEI and FORI*. FOGEI includes the taxable income from the extraction of minerals from oil or gas wells by a taxpayer (or another person) and from the sale or exchange of assets used in the extraction business. FORI includes taxable income from the activities of processing oil and gas into their primary products, transporting or distributing oil and gas and their primary products, and from the disposition of assets used in these activities. For this purpose, a disposition includes only a sale or exchange. FOGEI and FORI may also include taxable income from the performance of related services or from the lease of related property and certain dividends, interest, or amounts described in section 951(a). See §§ 1.907(c)-1 through 1.907(c)-3.

(f) *Posted prices*. Certain sales prices are disregarded when computing FOGEI for purposes of chapter 1 of the Code. See § 1.907(d)-1.

(g) *Transitional rules*. Section 907(e) provides rules for the carryover of unused FOGEI taxes from taxable years beginning before January 1, 1983, and carryback of FOGEI taxes arising in taxable years beginning after December 31, 1982. See § 1.907(e)-1.

(h) *Section 907(f) carrybacks and carryovers*. FOGEI taxes disallowed under section 907(a) may be carried back or forward to other taxable years. These FOGEI taxes may be absorbed in another taxable year to the extent of

the lesser of the separate excess extraction limitation or the excess limitation in the general limitation category (section 904(d)(1)(I)) for the carryback or carryover year. See § 1.907(f)-1.

(i) *Statutes covered*. The regulations under section 907 are issued as a result of the enactment of section 601 of the Tax Reduction Act of 1975, of section 1035 of the Tax Reform Act of 1976, of section 301(b)(14) of the Revenue Act of 1978, of section 211 of the Tax Equity and Fiscal Responsibility Act of 1982 and of section 1012(g)(6) (A)-(B) of the Technical and Miscellaneous Revenue Act of 1988.

[T.D. 8338, 56 FR 11065, Mar. 15, 1991]

§ 1.907(a)-1 Reduction in taxes paid on FOGEI (for taxable years beginning after December 31, 1982).

(a) *Amount of reduction*. FOGEI taxes are reduced by the amount by which they exceed a limitation level (as defined in paragraph (c) of this section).

(b) *Foreign taxes paid or accrued*. For purposes of the regulations under section 907—

(1) *Foreign taxes*. The term “foreign taxes” means income, war profits, or excess profits taxes of foreign countries or possessions of the United States otherwise creditable under section 901 (including those creditable by reason of section 903).

(2) *Foreign taxes paid or accrued*. The terms “foreign taxes paid or accrued,” “FOGEI taxes paid or accrued,” and “FORI taxes paid or accrued” include foreign taxes deemed paid under sections 902 and 960. Unless otherwise expressly provided, these terms do not include foreign taxes deemed paid by reason of sections 904(c) and 907(f).

(c) *Limitation level*—(1) *In general*. The limitation level is FOGEI for the taxable year multiplied by the limitation percentage for that year.

(2) *Limitation percentage for corporations*. A corporation's limitation percentage is the highest rate of tax specified in section 11(b) for the particular year.

(3) *Limitation percentage for individuals*. Section 907(a)(2)(B) provides that the limitation percentage for individual taxpayers is the effective rate of tax for those taxpayers. The effective rate of tax is computed by dividing the

entire tax, before the credit under section 901(a) is taken, by the taxpayer's entire taxable income.

(4) *Losses.* (i) For purposes of determining whether income is FOGEI, a taxpayer's FOGEI will be recharacterized as foreign source non-FOGEI to the extent that FOGEI losses for preceding taxable years beginning after December 31, 1982, exceed the amount of FOGEI already recharacterized. See § 1.907(c)-1(c). However, taxes that were paid or accrued on the recharacterized FOGEI will remain FOGEI taxes.

(ii) Taxes paid or accrued by a person to a foreign country may be FOGEI taxes even though that person has under U.S. law a net operating loss from sources within that country.

(iii) For purposes of determining whether income is FOGEI, a taxpayer's income will be treated as income from sources outside the United States even though all or a portion of that income may be resourced as income from sources within the United States under section 904(f) (1) and (4).

(5) *Priority.* (i) Section 907(a) applies before section 908, relating to reduction of credit for participation in or co-operation with an international boycott.

(ii) Section 901(f) (relating to certain payments with respect to oil and gas not considered as taxes) applies before section 907.

(d) *Illustrations.* Paragraphs (a) through (c) of this section are illustrated by the following examples.

Example 1. M, a U.S. corporation, uses the accrual method of accounting and the calendar year as its taxable year. For 1984, M has \$20,000 of FOGEI, derived from operations in foreign countries X and Y, and has accrued \$11,500 of foreign taxes with respect to FOGEI. The highest tax rate specified in section 11(b) for M's 1984 taxable year is 46 percent. Pursuant to section 907(a), M's FOGEI taxes limitation level for 1984 is \$9,200 ($46\% \times \$20,000$). The foreign taxes in excess of this limitation level (\$2,300) may be carried back or forward. See section 907(f) and § 1.907(f)-1 and section 907(e) and § 1.907(e)-1.

Example 2. The facts are the same as in *Example 1* except that M is a partnership owned equally by U.S. citizens A and B who each file as unmarried individuals and do not itemize deductions. Pursuant to section 905(a), A and B have elected to credit foreign taxes in the year accrued. The total amount of foreign taxes accrued by A and B with re-

spect to their distributive shares of M's FOGEI is \$11,500 (\$5,750 accrued by A and \$5,750 accrued by B). A and B have no other FOGEI. A's only taxable income for 1984 is his 50% distributive share (\$10,000) of M's FOGEI and A has a preliminary U.S. tax liability of \$1,079. B has \$112,130 of taxable income for 1984 (including his 50% distributive share (\$10,000) of M's FOGEI) and has a preliminary U.S. tax liability of \$44,000. Pursuant to section 907(a), A's FOGEI taxes limitation level for 1984 is \$1,079 ($(\$1,079/\$10,000) \times \$10,000$) and B's FOGEI taxes limitation level for 1984 is \$3,924 ($(\$44,000/\$112,130) \times \$10,000$).

(e) *Effect on other provisions*—(1) *Deduction denied.* If a credit is claimed under section 901, no deduction under section 164(a)(3) is allowed for the amount of the FOGEI taxes that exceed a taxpayer's limitation level for the taxable year. See section 275(a)(4)(A). Thus, FOGEI taxes disallowed under section 907(a) are not added to the cost or inventory amount of oil or gas.

(2) *Reduction inapplicable.* The reduction under section 907(a) does not apply to a taxpayer that deducts foreign taxes and does not claim the benefits of section 901 for a taxable year.

(3) *Section 78 dividend.* The reduction under section 907(a) has no effect on the amount of foreign taxes that are treated as dividends under section 78.

(f) *Section 904 limitation.* FOGEI taxes as reduced under section 907(a) are creditable only to the extent permitted by the general limitation of section 904(d)(1)(I).

[T.D. 8338, 56 FR 11066, Mar. 15, 1991]

§ 1.907(b)-1 Reduction of creditable FORI taxes (for taxable years beginning after December 31, 1982).

If the foreign law imposing a FORI tax (as defined in § 1.907(c)-3) is either structured in a manner, or operates in a manner, so that the amount of tax imposed on FORI is generally materially greater than the tax imposed by the foreign law on income that is neither FORI nor FOGEI ("described manner"), section 907(b) provides a special rule which limits the amount of FORI taxes paid or accrued by a person to a foreign country which will be considered income, war profits, or excess profits taxes. Section 907(b) will apply to a person regardless of whether that person is a dual capacity taxpayer as